



# World Economic Situation and Prospects

## Weekly Highlights

Prepared by Grigor Agabekian

14 August 2013

### Foreign exchange loan challenges in Hungary

Since the beginning of the 2008/09 crisis, the Government of Hungary has tried to address the problem of massive household indebtedness. Prior to the crisis, hundreds of thousands of households took long-term loans (as in many other countries in Eastern Europe),—mortgage loans in particular—denominated in foreign currencies, mostly the euro and the Swiss franc. The borrowers benefited from low interest rates on those loans, which were considerably lower than the rates charged for borrowing in domestic currency. However, plunging real estate values and a weakening currency dramatically complicated repayment of those loans in the aftermath of the crisis, severely curbing private consumption and impeding economic recovery. In 2011, the Government adopted repayment schemes, according to which foreign currency mortgage loans could be repaid with a lump sum at artificially weak exchange rates before maturity. Although some customers benefited from the schemes, and the total amount of outstanding foreign currency mortgages dropped by over 19 per cent, its cost to banks has been estimated at around \$1.2 billion.

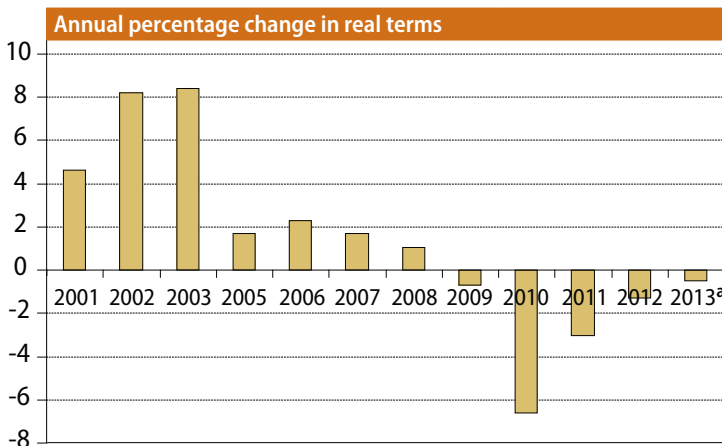
In the first quarter of 2013, the total value of the outstanding foreign currency denominated mortgages in Hungary still exceeded \$15 billion (an equivalent of 12 per cent

of the country’s 2012 GDP), and payments on about 20 per cent of them were overdue (see figure). The value of total outstanding foreign currency loans constituted 55 per cent of all loans. In July 2013, the Government discussed the issue. Although no decision was adopted, expectations that the conditions of the loans may be modified—by converting them to domestic currency, for example—have led major domestic banks’ shares to sink. The Government must weigh the pros and cons of shifting the burden from the households to the banks.

On the one hand, domestic demand in Hungary remains severely depressed, and the economy in early 2013 was exclusively driven by net exports. Resolving the issue of outstanding foreign currency loans, which are also the key source of vulnerability for the banking sector, may give a boost to private consumption, and eventually, to growth.

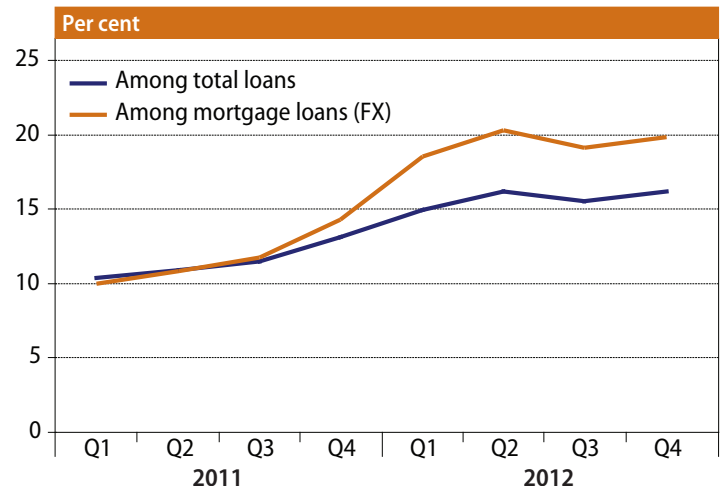
On the other hand, imposing additional losses on banks may have even more negative repercussions for the economy. In 2012, the Hungarian banking sector as a whole recorded a net loss. Accepting the entire exchange rate loss emanating from currency depreciation would cost the banking sector almost \$5 billion. This would not only curb credit recovery, but might also intensify capital outflows.

Figure 1: Private consumption in Hungary



Source: Project LINK.  
a Forecasts.

Figure 2: Share of non-performing loans in Hungary



Source: Hungarian National Bank.